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UNITED STATES DEPARTMENT OF JUSTICE

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SARA L. KISTLER

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

In re:

USA Commercial Mortgage Company
06-10725 -- Lead Case

USA Capital Realty Advisors, LLC
06-10726

USA Capital Diversified Trust Deed Fund, LLC
06-10727

USA Capital First Trust Deed Fund, LLC
06-10728

USA Securities, LLC
06-10729

Debtors

Jointly Administered

Chapter 11 Cases

Judge **Linda B. Rieggle** Presiding

Date: **May 18, 2006**

Time: **9:30 a.m.**

Affecting:

☐ All Cases

or Only:

☒ USA Commercial Mortgage Company

☐ USA Capital Realty Advisors, LLC

☒ USA Capital Diversified Trust Deed Fund,
LLC

☒ USA Capital First Trust Deed Fund, LLC

**THE UNITED STATES TRUSTEE'S OPPOSITION TO APPLICATION TO
EMPLOY SHEA & CARLYON, LTD. AS SPECIAL COUNSEL**

To the Honorable **LINDA B. RIEGLE**, United States Bankruptcy Judge:

The United States Trustee opposes the Application to Employ Shea & Carlyon, Ltd. as
Special Counsel, filed in connection with:

In re USA Commercial Mortgage Company, Case No. 06-10725;

In re USA Capital Diversified Trust Deed Fund, LLC, Case No. 06-10727; and

In re USA Capital First Trust Deed Fund, LLC, Case No. 06-10728.

1 The retention proposed in the application is inconsistent with the provisions of 11 U.S.C.
 2 § 1103(b), and would exacerbate actual and create potential conflicts of interest in the
 3 administration of the three separate estates affected by the application. This opposition is
 4 supported by the pleadings and papers comprising the official Court files in the three Chapter 11
 5 cases identified in the caption, and the following Memorandum of Points and Authorities.

6 **MEMORANDUM OF POINTS AND AUTHORITIES**

7 **JURISDICTION AND VENUE**

- 8 1. This Court has jurisdiction over the applications and this opposition pursuant to
 9 28 U.S.C. §§ 1334(a) and (b), and 28 U.S.C. §§ 157(a) and (b)(1).
- 10 2. The application and this opposition are premised upon 11 U.S.C. § 1103, and present
 11 the Court with a core proceeding under 28 U.S.C. §§ 157(b)(2)(A) and (O).
- 12 3. Venue is appropriate in the District of Nevada pursuant to 28 U.S.C. § 1409(a).

13 **FACTS**

14 4. On April 13, 2006, separate Chapter 11 bankruptcy petitions were filed in each of the
 15 five cases identified in the caption. As a result, there are five separate cases, five separate
 16 debtors, and five separate bankruptcy estates before the Court as of the filing of this opposition.¹
 17 Three of those separate cases are affected by the application and this opposition.

18 5. On May 9, 2006, the Court entered its Order Regarding Joint Administration Without
 19 Substantive Consolidation, noting "the potential conflicts of interest among the Debtors." *See*
 20 Docket # 184.

21 6. On May 10, 2006, the United States Trustee filed the following committee
 22 appointment papers relevant to this opposition:

- 23 a. Notice of Appointment of Official Committee of Holders of Executory
 24 Contract Rights Through USA Commercial Mortgage Company [Docket
 # 202];
- 25 b. Notice of Appointment of Official Committee of Equity Security Holders
 26 of USA Capital Diversified Trust Deed Fund, LLC [Docket # 203]; and

27
 28 ¹*See, e.g., In re Interwest Bus. Equip., Inc.*, 23 F. 3d 311, 316 n. 9 (10th Cir. 1994).

1 c. Notice of Appointment of Official Committee of Equity Security Holders
2 of USA Capital First Trust Deed Fund, LLC [Docket # 204].

3 7. On May 17, 2006, each of the official committees identified in the preceding
4 paragraph held separate organizational meetings.

5 8. On May 19, 2006, the Shea firm filed the application.

6 **CONTROLLING STATUTES AND POLICIES**

7 9. Committees stand as fiduciaries with respect to the class of interests they represent,
8 and their principal function is to advise the members of that class of interests of their rights and
9 the proper course of action in bankruptcy proceedings. In re Caldor, Inc., 193 B.R. 165, 169
10 (Bankr. S.D.N.Y. 1996)(citations omitted).

11 10. In the discharge of their duties, committees are expressly authorized to retain counsel
12 pursuant to 11 U.S.C. § 1103(a). The application, requesting authorization for the Shea firm to
13 jointly represent all three of the separate committees, is based upon that section.

14 11. Committees' authority to retain counsel under 11 U.S.C. § 1103(a) is limited by 11
15 U.S.C. § 1103(b), which generally provides that counsel for a committee "may not, while
16 employed by such committee, represent any other entity having an adverse interest in connection
17 with the case."

18 12. An attorney retained by a committee owes a fiduciary duty to that committee. The
19 limitations on committees' authority to retain counsel established by 11 U.S.C. § 1103(b) "serve
20 the important policy of ensuring that all professionals . . . tender undivided loyalty and provide
21 untainted advice and assistance in furtherance of their fiduciary responsibilities." In re
22 Greystone Holdings, L.L.C., 305 B.R. 456, 460 (Bankr. N.D. Ohio 2003), *quoting* In re Crivello,
23 134 F.3d 831, 836 (7th Cir. 1998) *and* Rome v. Braunstein, 19 F.3d 54, 58 (1st Cir. 1994).

24 13. The restrictions on committees' authority to retain counsel imposed by 11 U.S.C.
25 § 1103(b) are intended to maintain the integrity of the bankruptcy system, and professionals
26 retained by committees must not "place themselves in a situation where their independence,
27 loyalty and integrity can be questioned by the unsecured creditor body whom they represent."
28

1 Greystone, 305 B.R. at 460, *quoting In re Oliver's Stores, Inc.*, 79 B.R. 588, 597 (Bankr. D.N.J.
2 1987).

3 14. The disclosures required of a professional seeking employment by a committee
4 under 11 U.S.C. § 1103 are set forth in Fed. R. Bankr. P. 2014(a).

5 AUTHORITY AND ARGUMENT

6 BECAUSE THE COMMITTEES ARE SEPARATE ENTITIES, AND ADVERSE 7 INTERESTS EXIST BETWEEN THEM, THE JOINT COMMITTEE 8 RETENTION PROPOSED IN THE APPLICATION SHOULD BE DENIED.

9 15. The term "adverse interest" used in the text of 11 U.S.C. § 1103(b) is not defined in
10 the Bankruptcy Code. In re Greystone Holdings, L.L.C., 305 B.R. 456, 461 (Bankr. N.D. Ohio
11 2003), *citing In re Caldor, Inc.*, 193 B.R. 165, 171 (Bankr. S.D.N.Y. 1996); *see generally*, 7
12 ALAN N. RESNICK ET AL., COLLIER ON BANKRUPTCY ¶ 1103.04[2] (15th ed. 2006) ("The Code
13 does not define adverse interest, and the concept has been left to the development of case law.").

14 16. Various courts have held that "adverse interest" means "(1) to possess . . . an
15 economic interest that would tend to lessen the value of the bankruptcy estate or that would
16 create either an actual or potential dispute in which the estate is a rival claimant; or (2) to
17 possess a predisposition under circumstances that render such a bias against the estate.
18 Greystone, 305 B.R. at 461, *quoting In re Fretter*, 219 B.R. 769, 777 (Bankr. N.D. Ohio 1998)
19 and In re Roberts, 46 B.R. 815, 826-27 (Bankr. D. Utah 1985), *rev'd in part on other grounds*,
75 B.R. 402 (D. Utah 1987).

20 17. An "adverse interest" is sufficient to disqualify counsel where the proposed
21 representation gives rise to "either a meaningful incentive to act contrary to the best interest of
22 the [committee] -- an incentive sufficient to place those parties at more than acceptable risk -- or
23 the reasonable perception of one." Greystone at 461, *quoting In re Caldor, Inc.*, 193 B.R. at 171
24 and In re Martin, 817 F.2d 175, 180 (1st Cir. 1987). When it is plausible that representation of a
25 committee will cause proposed counsel to act any differently than they would if they did not
26 represent the committee, then an "adverse interest" is present, and a disqualifying conflict of
27 interest exists. Greystone at 461, *quoting In re Leslie Fay Co., Inc.*, 175 B.R. 525, 533 (Bankr.
28 S.D.N.Y. 1994).

1 18. The Official Committee of Holders of Executory Contract Rights Through USA
2 Commercial Mortgage Company is comprised and representative of parties whose investment
3 monies were used to fund a particular commercial development project, in exchange for which
4 they apparently received a fractional share of the related promissory note and first trust deed in
5 that particular commercial development project. The Court has previously referred to these
6 parties as "Direct Investors."

7 19. The official equity security holder committees appointed in the USA Capital
8 Diversified Trust Deed Fund, LLC, and USA Capital First Trust Deed Fund, LLC, cases are
9 comprised and representative of parties who received an ownership interest in the debtor Fund
10 LLCs in exchange for their investment money, not a lien against a particular commercial
11 development project. The Court has previously referred to these parties as "Fund Investors."
12 The debtor Fund LLCs used the Fund Investors' money to finance a number of different
13 commercial development projects, in exchange for which the debtor Fund LLCs apparently
14 received fractional shares of the related promissory notes and first trust deeds for the benefit of
15 the Fund Investors.

16 20. The most recent Declaration of Thomas J. Allison in Support of Debtors' Motions
17 [Docket # 130] reveals that certain commercial development projects have been funded using
18 money made available both by Direct Investors and by money the debtor Fund LLCs received
19 from the Fund Investors; that in some instances, "more than one loan is secured by the same real
20 estate"; and that "a large portion of the Loan Investors received monthly payments from
21 USACM that they were not entitled to receive (because they were invested, at least in part, in
22 one or more Nonperforming Loans), and thus such investors owe a debt to USACM for the
23 amounts overpaid to them." *See* Allison Declaration at ¶¶ 3 - 12.

24 21. There is an unsecured and improperly documented \$58 million intercompany
25 receivable owed by a non-debtor entity, USA Investment Partners, LLC, to USA Commercial
26 Mortgage "and possibly to other Debtors", which Allison is purportedly close to having executed
27 "for the benefit of the Debtors, the [Direct Lenders], and the Fund Members." Allison
28 Declaration at ¶ 20.

22. The status of intercompany transactions between the various debtors is under investigation, and has not yet been disclosed to the Court or parties in interest. Allison Declaration at ¶ 18.

23. Some Direct Investors, whose interests are aligned with those parties represented by the Official Committee of Holders of Executory Contract Rights Through USA Commercial Mortgage Company, are currently seeking to:

- a. Compel USA Commercial Mortgage to forward borrower payments immediately to the relevant Direct Investors, arguing that only the loan servicing fee components of those payments are property of any of the bankruptcy estates identified in the caption; *see, e.g.*, Docket # 209; and
- b. Obtain relief from the automatic stay to terminate USA Commercial Mortgage as their loan servicer; *see, e.g.*, Docket # 208.

24. For their part, all five of the Debtors have asked for permission from the Court to "temporarily" collect and hold significantly all payments received from borrowers under the loans at issue in these cases, until a July 25, 2006 hearing can be held to determine who is entitled to the money: The Direct Investors, the Fund Investors, and/or one or more of the Debtors. *See* Debtors' Motion to Temporarily Hold Funds Pending a Determination of the Proper Recipients, and Memorandum of Points and Authorities [Docket # 173].

25. When the contents of the motions referenced above are read together with the Allison Declaration, the following are only some of the "adverse interests" that become evident, such that the proposed retention of the Shea firm by more than one committee is prohibited by 11 U.S.C. § 1103(b):

- a. Where borrowers have made payments on a loan funded by Direct Investors, and the payments were improperly used to make interest payments on loans funded by the debtor Fund LLCs, the interests of the Direct Investors would be served by pursuing recovery from the Fund LLCs. Such claims by the Direct Investors would "tend to lessen the value of the [Fund LLCs'] bankruptcy estate, in a manner detrimental to the interests of [the Fund Investors and] the committees appointed to represent them." The reverse is also true. *See Greystone*, 305 B.R. at 461.
- b. In those instances where more than one loan is secured by the same real estate, and all investors believe that they held an interest in a *first* trust deed in the real estate, there is an actual or potential priority dispute in which the Direct Investors and the estates of the Fund LLCs are rival claimants. *See* Allison Declaration at ¶ 3; *Greystone*, 305 B.R. at 461.

- c. Ultimately, to the extent that there is insufficient money recovered to pay all of the claims of all of the Direct Investors, the Fund Investors, and the Debtors (to the extent they hold any valid claims to the money), there is an actual or potential priority dispute in which the Direct Investors and the estates of the Fund LLCs are rival claimants. It is likely, not uncertain, that such will prove to be the case, as "Nonperforming Loans represent 54% in number, and 72% in outstanding loan balance, of the Serviced Loans." *See* Allison Declaration at ¶ 4; Greystone, 305 B.R. at 461.

26. Finally, Allison's Declaration posits that there are at least two types of prepetition debts owed by two of the debtors (USA Capital Diversified Trust Deed Fund and USA Capital First Trust Deed Fund) to another debtor (USA Commercial Mortgage Company):

- a. Loan servicing fees under the debtors' Loan Servicing Agreements; and
- b. Amounts purportedly due to USA Commercial Mortgage Company from USA Capital Diversified Trust Deed Fund and USA Capital First Trust Deed Fund as a result of monthly payments made by USA Commercial Mortgage Company in connection with one or more nonperforming loans prior to bankruptcy.

See Allison Declaration at ¶¶ 5-9, 11, and 28 - 30.

27. An actual conflict of interest exists, and counsel should be prohibited from representing multiple committees in related bankruptcy cases pursuant to 11 U.S.C. § 1103(b), when "each committee potentially [holds] an interest in each case adverse to the others' committees by virtue of the fact that each debtor was a creditor of the others." *See In re Caldor, Inc.*, 193 B.R. 165, 177-78 (Bankr. S.D.N.Y. 1996), *citing In re Proof of the Pudding, Inc.*, 3 B.R. 645, 646-48 (Bankr. S.D.N.Y. 1996).

CONCLUSION

In summary, 11 U.S.C. § 1103(b) constitutes "a blanket prohibition on representing another entity . . . in connection with the case at the same time that the professional is representing the committee." 7 ALAN N. RESNICK ET AL., *COLLIER ON BANKRUPTCY* ¶ 1103.04[2] (15th ed. 2006). Allowing the Shea firm to represent multiple committees in these interrelated bankruptcy cases is entirely inconsistent with the "blanket prohibition" established by the provisions of 11 U.S.C. § 1103(b).

The United States Trustee therefore respectfully requests that the Court enter an order denying the application, and granting such other and additional relief as is just and equitable.

Respectfully submitted,

SARA L. KISTLER
ACTING UNITED STATES TRUSTEE
REGION 17

By: /s/ August B. Landis
August B. Landis, Assistant United States Trustee
United States Department of Justice

CERTIFICATE OF SERVICE

I, the undersigned, certify that on this date I served the United States Trustee's
Opposition to Application to Employ Shea & Carlyon, Ltd. as Special Counsel:

1. Electronically upon all counsel and parties in interest on the CM/ECF service list as of May 26, 2006; and
2. By depositing an envelope in the United States Mail, first class postage fully prepaid and addressed to each of the parties listed below, each of which contained a true and correct copy of the United States Trustee's Opposition to Application to Employ Shea & Carlyon, Ltd. as Special Counsel:

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Gregory J. Walch
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Las Vegas, NV 89101

Dated: May 26, 2006

OFFICE OF THE UNITED STATES TRUSTEE

SARA L. KISTLER
ACTING UNITED STATES TRUSTEE
REGION 17

By: /s/ August B. Landis
August B. Landis
Assistant United States Trustee
Las Vegas, Nevada

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